WRITTEN TESTIMONY OF PAUL V. MCCORD
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BEFORE THE HOUSE TAX POLICY COMMITTEE
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Good morning Chairman Bieda and members of the Committee. My name is Paul McCord and I thank you for the opportunity to provide some written comments and perspectives in support of House Bills, 4433, 4434, 4435, 4436 and 4437 which are designed to provide Michigan taxpayers more meaningful access to the Tax Tribunal, more choices in determining a resolution process that fits the needs of their cases and their budgets, and streamlines the Tax Tribunal's procedures which should reduce the Tribunal's administrative costs.

BACKGROUND

By way of background, I am a Tax attorney with the law firm of Varnum, Riddering, Schmidt & Howlett LLP. Established in 1888, Varnum, Riddering, Schmidt & Howlett LLP is a leading Michigan law firm with more than 160 attorneys in six offices. Varnum serves as counsel to growing businesses and institutions throughout Michigan and the Midwest. I am also the Chairperson of the State and Local Tax Committee of the Tax Section of the State Bar of Michigan. The Tax Section of the State Bar of Michigan is the premier organization representing the interests of both the public and the approximately 1,500 Michigan tax lawyers to achieve equitable, efficient, and workable federal, state and local tax systems. Over the past twelve years, I have accumulated a diverse range of experience in both federal and state and local tax planning, transactional and tax litigation in government, industry and private practice.

There is no doubt about the importance of taxes in our society. Michigan is in the middle of debating its current tax systems and the impact of these systems on our inter-state competitiveness, job creation, and their importance in our shared economic prosperity. Taxes permeate almost every aspect of the law and our daily lives. Early on in our country's history, the United States Supreme Court recognized the importance of taxes when it said that the power to tax is the power to destroy.[1] Because of this immense power, we need an independent forum, like the Michigan Tax Tribunal to adjudicate tax controversies between the government and its citizens.

Further, the Tax Tribunal plays an important role in our state's competitiveness. With regard to assessing Michigan's tax climate, our recent experience with the Single Business Tax demonstrates that perceptions are often as important as the objective economic measurement of the tax burden. Frequently overlooked in tax reform efforts, however, are the efficiencies of the state's tax administration, including its tax appeal systems. At times, the Tax Tribunal has been harshly criticized for its inefficiencies, accountability and perceptions of bias. That said, the Tax Tribunal has been examining its own internal practices, as well as its external practices and procedures in order to address these concerns. This has been an ongoing process for almost the last four years. In this current season of tax reform, it is encouraging to see that tax administration and

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[1] *See McCulloch v. Maryland*, 17 U.S. 316, 431 (1819).

appeals processes has not been forgotten. The package of Bills before you today is just one part of this government reform effort.

THE PROBLEM

Whether express or implied, tax professionals operate within the mantra of providing cost-effective services and quality advice to those who hire us. We do this by developing ways to help businesses operate more efficiently and effectively within their available budget and resources. Lurking below the surface of this process is the fact that much of what is done (or not done) focuses on "staying out of trouble," *i.e.*, keeping the operations running smoothly and away from disputes. There is almost an instinctive perception that taking time away from the business to address a dispute results in the loss of not only the actual time, money, and emotion spent in directing attentions to the problem, but also the opportunity to use those same qualities toward growing the business.

Further, when disputes with tax authorities – whether state, local, or federal – arise, as they surely will, the options for quickly and effectively untangling from the dispute shrink to a measly few. At one extreme, one can set up a get-together with the other party (*i.e.*, negotiation) and attempt to work it out. Unfortunately, there are always some taxpayers and/or employees of either the local tax authorities or the Department of Treasury whose attitude makes cooperation seem pointless, particularly where there is no incentive to cooperate.[2] As a result, if negotiation does not work, parties normally move to "dukeing it out" through some form of formal adversarial process such as litigation.

For most individuals and businesses, this last set of alternatives is often personally distasteful, emotionally draining, and counterproductive to business operations. Litigation involves the burden of time and money, and generally produces a less-than-desired result. Time and time again in discussions with business people and clients, we hear the adage that "the only people who made money in this deal are the lawyers."

Each year the Tax Tribunal receives about 8,000 new cases. The responsibility for managing and resolving these cases falls on the 7 members or judges authorized under current law. By way of comparison, the United States Tax Court receives approximately 20,000 cases per year. There are 19 judges, 7 Special Trial Judges (analogous to magistrates) and about 8 judges on Senior status (retired judges recalled to part-time duty).

As a result of the volume of cases and limited resources, litigation of tax disputes in Michigan has become progressively more expensive, both in money and in time, for taxpayers, the government, and the Tax Tribunal. Complex valuation cases are particularly challenging as the Tax Tribunal, given its very limited resources, is

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[2] One piece of the picture that is often overlooked is the fact that businesses develop, often unintentionally, a compartmentalized incentive structure for management that rewards them by the profit from a particular business unit, be it a division, a profit unit, or otherwise rather than the business' overall profit. If the manager knows that settlement amounts will be charged to his or her profit center but litigation costs are classified as general overhead (*i.e.*, not charged to his or her profit center), there is no rocket science to figuring out which of the two options a manger would pick. Couple that with the fact that the manager may be able to prolong the dispute through litigation beyond his or her tenure in the position, and powerful incentives arise for *not* wanting to reach a quick settlement.

frequently overwhelmed by the mass of data it is required to sift through, organize, and comprehend. The passage of HB 4433, 4434, 4435, 4436 and 4437, will aid the Tax Tribunal in maximizing its scarce resources, improving the efficiency of Michigan's tax appeal process, and increasing Michigan's perceived tax competitiveness.

HB 4434 – MEDIATION

As an initial matter, an advisor must consider whether full cooperation with either the local tax authorities or the taxpayer (depending on who the advisor represents) will result in an acceptable settlement at a very early stage. In valuation cases, there is never only one correct number, but rather always a reasonable range. Efforts to identify that range early often lead to settlement. Unfortunately, the procedures and systems currently in place do not go far enough to encourage parties to participate in meaningful discussions early on.

Surveys of businesspeople in various industries uniformly report that a substantial majority of those businesspeople and professionals who have tried some form ADR came away with a positive attitude toward the process, found it to be more efficient and effective than litigation.

My personal experience with Alternative Dispute Resolution techniques or ADR in tax matters has been in the context of Federal Tax controversies in the United States Tax Court. In the 1990's, the United States Tax Court publicly urged the use of Alternative Dispute Resolution to resolve factual issues in docketed cases. In 1990, the court added Rule 124 to its Rules of Practice and Procedure to encourage voluntary binding arbitration in docketed cases and to provide a formal procedure to accomplish this.

Initially, the court expected that arbitration would be used primarily in valuation cases. Early experience with Rule 124 bears out the court's expectation. Binding arbitration under Rule 124 reportedly has been used in valuation disputes over real estate, trucking licenses, closely held stock, mineral property, patents, and citrus groves.

In federal tax procedure, the parties typically stipulate some minimal factual background that they submit to the arbitrator. The parties do not generally hold mini-trials before the arbitrator or present the arbitrator with oral argument. The arbitrator usually is free to pick any number he or she feels is appropriate for the value, *i.e.*, the arbitrator is not given a choice between only two numbers submitted by the parties ("baseball arbitration") or confined to a range ("high/low arbitration"). The arbitrator usually submits a report containing a valuation figure, but no explanation or written report to justify that figure.

Over the past 17 years, however, the Tax Court's experience with Rule 124 has been that it is used infrequently, which may be due largely to the fact that the process is "binding," *i.e.*, the parties must agree to be bound by the findings of the arbitrator on the issues submitted for arbitration. HB 4433 provides for nonbinding mediation, so, hopefully Michigan's experience should prove more fruitful than that of the Tax Court's.

In adopting Rule 124, however, the Tax Court stressed that "the Rule is not intended to be unduly restrictive or to discourage innovative and imaginative approaches to

arbitration, nor is it intended to preclude voluntary, non-binding arbitration." Former Chief Judge Nims stated, "Rule 124 probably is broad enough to include mediation as a formal matter."

Mediation has occurred in the Tax Court in the past on an *ad hoc* basis, with increasing frequency, generally at the suggestion of either the parties or the court. Mediation offers many advantages for both the taxpayer and the government. Mediation is not binding, and the parties are generally free to structure the mediation to suit their needs. However, in regards to mediation contemplated by HB 4434, the structure of the mediation process should remain under the supervision of the Tax Tribunal as it may direct.

Assuming the mediators are qualified to analyze the issues, mediation offers the parties a preview of how his or her position may be viewed at trial. Drawing from my experience in the Tax Court, if the mediators will not accept a party's argument, the Tax Tribunal may not either, increasing the likelihood of settlement. Properly conducted, the mediation process should foster an atmosphere conducive to settlement. If mediation is successful, the parties will have obtained an acceptable result in less time, at less cost, and with less risk and uncertainty than would be incurred in litigation. Further, the availability of mediation should assist the Tax Tribunal in reducing its docket case load, preserving its scarce resources for cases that, given their factual or legal nature are not ripe for mediation. The only downside to mediation is, perhaps, the costs incurred if the mediation is not successful and the lost opportunity of a more favorable result in litigation.

In summary, mediation will offer Michigan taxpayers substantial advantages – and few disadvantages – in cases where differences between the taxpayer and government are unresolved.

HOUSE BILL 4434

House Bill 4434 eliminates the restriction that not more than three Tax Tribunal members shall be members of the same professional designation. This allows more flexibility in finding the best qualified candidates and expands the pool of qualified applicants.

Under current law, if an otherwise qualified candidate wishes to be appointed as a member of the Tax Tribunal, he or she could be precluded from further consideration if another sitting member holds the same profession credentials as the candidate. As a result, if the position is left vacant do to a lack of qualified candidates, additional strain is imposed on the Michigan tax appeal system and, in turn, Michigan taxpayers and government are forced to bear this burden in the form of additional time and increased litigation expense.

Adoption of HB 4433 and 4434, in conjunction with the increased threshold for small claims cases and providing for continuation funding for ongoing cases, will make the Tax Tribunal more accessible, efficient, and effective.

Thank you again for the opportunity to address the Committee.